Inherited IRAs After the SECURE Act

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RMDs, Penalty-Free Withdrawals and Loans After the CARES Act

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INTRODUCTION TO THE SECURE ACT

“Setting Every Community Up for Retirement Enhancement” [SECURE] Act of 2019

- Passed by Congress in December of 2019
- Most significant legislation to affect retirement plans and IRAs since 2006
- The following slides discuss the most important changes made by the SECURE Act

I. Age For RMDs Increased to 72

- Effective for individuals who attain age 70 ½ after December 31, 2019, the required beginning date ("RBD") to start receiving required minimum distributions ("RMDs") from an IRA or retirement plan is now April 1 following the calendar year in which the individual attains age 72
  - The RBD was previously April 1 following the calendar year in which the individual attained 70 ½

- Exception for employer-maintained plans: If you are still working for an employer and you do not own 5% or more of the employer, your RBD will be April 1 following the later of:
  - The calendar year in which you attain age 72, OR
  - The calendar year in which you terminate employment
  - (If you do own 5% or more of your employer, this exception does not apply)

II. No Age Limit on Contributions to Traditional IRAs

- Individuals age 70 ½ and older may now make contributions to a traditional IRA for the 2020 calendar year and thereafter
  - This is effective for deductible and non-deductible contributions
- Prior to the SECURE Act, individuals age 70 ½ and older were not permitted to contribute to a traditional IRA
- Note: There has never been an age limit on contributions to a Roth IRA

III. Partial Elimination of Stretch IRA
A. Introduction

- With several exceptions, after the death of the employee/IRA owner, inherited benefits now must be distributed to the beneficiaries <u>within 10 years</u> after death
  - Deadline: December 31 of the 10th full calendar year after the death of the employee/IRA holder

- This change affects IRAs (including Roth IRAs) and "individual account" retirement plans such as profit sharing, 401(k), 403(b), and 457(b) plans
  - It does not affect benefits from a defined benefit plan, which are typically paid in the form of a lifetime annuity

III. Partial Elimination of Stretch IRA
A. Introduction (cont.)

- Prior to this change, individual beneficiaries (and beneficiaries of certain trusts) could “stretch” the payout of the RMDs over their life expectancies, which would reduce the income taxes associated with the benefits

- Reasons for eliminating the stretch IRA:
  - Congress wants to force the money out more quickly to raise revenue (the elimination of the stretch is contained in the “Revenue Raiser” portion of the Act)
  - Congress has concluded that inherited retirement benefits are an inheritance and have nothing to do with the beneficiary’s own retirement (unless the beneficiary is a spouse), so there is no need to allow tax-deferred growth of the inherited benefits over the beneficiary’s life.

III. Partial Elimination of Stretch IRA
B. Definitions

- 1. "Designated Beneficiary" ("DB") includes only the following:
  - a. Individuals
  - b. "See-through" trusts.
    - i. Requirements for a see-through trust (pre-SECURE Act rules still apply):
      - Valid under state law
      - Irrevocable upon death of participant
      - Trust document must be provided to plan administrator by October 31 of year following participant's death
      - All beneficiaries must be individuals
      - Beneficiaries must be identifiable

Note: Date of determining whether all trust beneficiaries are individuals and are identifiable is September 30 of year following participant's death. If distributions to all non-individual beneficiaries (e.g., charities) are made prior to this deadline, the trust can still qualify as a "see-through" trust.

III. Partial Elimination of Stretch IRA
B. Definitions (cont.)

b. "See-through" Trusts (cont.)

ii. Conduit Trusts

1. All distributions from the plan (RMDs and any other distributions) are required to be distributed by the trustee to the current individual beneficiary for such beneficiary's entire life.

2. Any other beneficiaries who will receive distributions after the death of the current beneficiary are disregarded in determining whether the trust is see-through, as those beneficiaries are deemed to be mere "successors" under the IRS's Treasury Regulations.

iii. Accumulation Trusts

1. All distributions from the plan are not required to be distributed to the current beneficiary (e.g., the trustee has discretion to pay income and principal to the beneficiary for "HEMS"). A portion or all of the distributions may be accumulated and held in trust for contingent beneficiaries

2. The other beneficiaries who will receive distributions after the death of the current beneficiary are considered in determining whether the trust is "see-through," as they are seen as "contingent" beneficiaries under the Treasury Regulations. If any contingent beneficiary is a non-individual, the trust does not qualify as "see-through" and therefore cannot be a DB.

III. Partial Elimination of Stretch IRA
B. Definitions (cont.)

Contingent vs. successor beneficiary – T.R. § 1.401(a)(9)-5, Q&A-7(b) and (c)(1):

"(b) Contingent beneficiary. Except as provided in paragraph (c)(1) of this A-7, if a beneficiary's entitlement to an employee's benefit after the employee's death is a contingent right, such contingent beneficiary is nevertheless considered to be a beneficiary for purposes of determining whether a person other than an individual is designated as a beneficiary (resulting in the employee being treated as having no designated beneficiary under the rules of A-3 of Section 1.401(a)(9)-4) and which designated beneficiary has the shortest life expectancy under paragraph (a) of this A-7.

(c) Successor beneficiary--

(1) A person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy under paragraph (a) of this A-7, or whether a person who is not an individual is a beneficiary, merely because the person could become the successor to the interest of one of the employee's beneficiaries after that beneficiary's death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to an employee's benefit beyond being a mere potential successor to the interest of one of the employee's beneficiaries upon that beneficiary's death. Thus, for example, if the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), both beneficiaries must be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries."

III. Partial Elimination of Stretch IRA
B. Definitions (cont.)

- 2. “Eligible Designated Beneficiary” (“EDB”) includes the following:
  - a. Spouse
  - b. Children of the IRA owner or participant in the retirement plan who have not attained the age of “majority”
  - c. Permanently disabled – I.R.C. § 72(m)(7)
  - d. Chronically ill – I.R.C. § 7702B(c)(2)
  - e. Not more than 10 years younger

III. Partial Elimination of Stretch IRA
B. Definitions (cont.)

- 3. “Non-Designated Beneficiary” (“NDB”) includes the following:
  - a. Estates (in general). Exception:
    - A surviving spouse can receive a distribution of retirement benefits through an estate and make a 60-day rollover into the spouse’s own IRA if he or she is (1) the sole personal representative of the estate, (2) the sole beneficiary of the estate, and (3) has the right to demand an outright distribution from the estate (PLR 200406048). In this case, the surviving spouse is treated as an EDB.
  - b. Charitable organizations, including charitable remainder trusts (CRTs)
  - c. Trusts that are not “see-through” and therefore are not DBs
  - d. Any other persons who are not individuals

III. Partial Elimination of Stretch IRA
B. Definitions (cont.)

4. RBD – Required beginning date

5. RMD – Required minimum distribution

6. HEMS – "health, education, maintenance, and support." If a Trustee has the ability to make distributions to trust beneficiaries for HEMS, this is considered to be an ascertainable standard.

III. Partial Elimination of Stretch IRA
C. New Distribution Rules

- 1. Death of employee/IRA owner <u>on or after</u> RBD
  - a. <u>Non DB</u>: Payout period is the "ghost rule" – remaining life expectancy of decedent (Age 72 – 17.2 years; age 81 – 10.5 years)
  - b. <u>DB who is not an EDB</u>: December 31 of 10th calendar year following death
    - Or, if longer, the ghost rule? IRS or Congress needs to clarify. Pre SECURE-Act law allowed a DB to choose to use the ghost rule, and it is unclear if this option remains open now.
    - When the DB dies, the payout period is the remainder of the 10-year period (or possibly, the remainder of the ghost rule period?).
  - c. <u>EDB</u>:
    - i. Surviving Spouse – Pre-SECURE Act rules still apply. Spouse may (1) roll benefits into own IRA, and the benefits will be treated as his/her own, or (2) not roll benefits over, and receive distributions over the spouse's own life expectancy commencing on the later of (a) the year the decedent would have turned 72, or (b) the year after decedent's death.
    - ii. Minor child – Must take RMDs based on child's life expectancy until child reaches "age of majority." Must withdraw remaining benefits within 10 years of the date the child reaches majority
    - iii. Permanently disabled or chronically ill – life expectancy
    - iv. Not more than 10 years younger beneficiary – life expectancy.
    - When the EDB dies (other than a surviving spouse who rolled the benefits to his/her own IRA), the payout period for the successor beneficiary is December 31 of 10th calendar year following the <u>EDB's death</u>
      - What if successor beneficiary is also an EDB, or is a non DB? Most likely still the 10-year rule.

III. Partial Elimination of Stretch IRA
C. New Distribution Rules (cont.)

- What is “age of majority”?
  - a. The SECURE Act refers to I.R.C. § 401(a)(9)(F), which refers to “regulations prescribed by the Secretary” (i.e. IRS Treasury Regulations)
  - Treasury Regulations § 1.401(a)(9)-6, Q&A 15 (issued under § 401(a)(9)(F)) describes “age of majority” as follows:
    - “…a child may be treated as having not reached the age of majority if the child has not completed a specified course of education and is under the age of 26. In addition, a child who is disabled within the meaning of section 72(m)(7) when the child reaches the age of majority may be treated as having not reached the age of majority so long as the child continues to be disabled.”
- Outstanding question: What is a “specified course of education”?

III. Partial Elimination of Stretch IRA
C. New Distribution Rules (cont.)

- 2. Death of employee/IRA owner before RBD
  - a. Non DB: December 31 of 5th calendar year following death
  - b. DB who is not an EDB: December 31 of 10th calendar year following death (we know for certain the "ghost rule" is not available in this case).
  - c. EDB – Same as if death occurred on or after RBD.

III. Partial Elimination of Stretch IRA
D. Trusts as DBs

- 1. Conduit Trusts – Always qualify as DB if current trust beneficiary is an individual
  - a. Major disadvantage to conduit trusts under the new rules - payout to the trust beneficiary is accelerated since the trust beneficiary can no longer use his/her own life expectancy (unless beneficiary is also an EDB who is eligible to use his/her own life expectancy). Benefits cannot be retained in the trust.
  - b. Example: Conduit trust for a 3-year old grandchild. Under prior rules, the RMDs payable to the conduit trust would be paid over an 81.7 year period. Under the SECURE Act, the grandchild will receive the entire interest in the IRA by age 13.
- 2. Accumulation Trusts – Qualify as DB only if all beneficiaries who could possibly receive retirement benefits are individuals (Note: if any beneficiary has a "power of appointment" which would allow him/her to appoint property to non-individuals, the trust must state that such power is not exercisable with respect to retirement benefits).
  - a. Major disadvantage to accumulation trusts under the new rules – Accumulation trust for an individual who otherwise qualifies as an EDB (e.g., spouse or minor child) will have a 10-year payout. If the benefits were left directly to the EDB, or to a conduit trust for the EDB, the EDB could stretch the payout over a longer period.
  - b. Example. Accumulation trust for lifetime benefit of the decedent's brother who is not more than 10 years younger than the decedent, with remainder payable to the brother's children (who are not EDBs). If the brother was directly named as the beneficiary, he could stretch the payments over his lifetime. But, because the benefits were left to an accumulation trust, the payout period is 10 years.

III. Partial Elimination of Stretch IRA
E. Trusts as EDBs

- 1. Conduit Trusts – Qualify as EDB if lifetime beneficiary of trust is EDB
  - a. Major Disadvantage under new rules – For children who are EDBs, payouts accelerate since the child's life expectancy cannot be considered after attaining majority.
  - b. Example: Conduit trust for an 8-year old child. Under prior rules, the RMDs payable to the conduit trust would be paid over a 76.8 year period. Under the SECURE Act, the child will receive all payments by, at the latest age 36 (assuming the child has not completed a specified course of education by age 26).
- 2. Accumulation Trusts – Most will not qualify as EDBs.
  - a. Spouse. Because the spouse is not the only beneficiary of the trust, a trust for the spouse will not qualify as an EDB (remainder beneficiaries <u>are</u> taken into consideration with respect to accumulation trusts).
    - i. Example: A qualified terminal interest property ("QTIP") trust paying all income to spouse, plus principal only for HEMS, with remainder paid in equal shares to children upon death of spouse.
    - ii. The QTIP is a DB but not an EDB because the spouse is not the only beneficiary. Accordingly, rather than payments to the QTIP over the spouse's life expectancy, the payments must be made to the QTIP over a 10 year period.

III. Partial Elimination of Stretch IRA
E. Trusts as EDBs (cont.)

- 2. Accumulation Trusts (cont.)
  - b. Child.
    - i. Example. Income and principal to 8-year old child for HEMS until age 30, at which time distribution outright to child. If child dies before attaining age 30, to child's issue per stirpes, or if no issue then to trustor's issue per stirpes.
    - ii. Trust is a DB but not an EDB. Rather than lifetime payouts to child from age 8 until attaining "majority," and then full payout in another 10 years, payments must be made to trust over 10 years. Possible 28-year payout (18 years until age of majority (26), assuming the child has not completed a specified course of education, plus 10 years thereafter) is reduced to 10 years.
  - c. Beneficiary not more than 10 years younger. Same as an accumulation trust for a spouse. A lifetime payout is reduced to 10 years.
  - d. Disabled or chronically ill – An accumulation trust <u>can</u> qualify as an EDB and receive distributions over the disabled or chronically ill beneficiary's life expectancy. See the following slides regarding an "applicable multi-beneficiary trust."

III. Partial Elimination of Stretch IRA
E. Trusts as EDBs (cont.)

"Applicable Multi-Beneficiary Trust"

- I.R.C. § 401(a)(9)(H)(v) "APPLICABLE MULTI-BENEFICIARY TRUST - For purposes of this subparagraph, the term "applicable multi-beneficiary trust" means a trust—
  - (I) which has more than one beneficiary,
  - (II) all of the beneficiaries of which are treated as designated beneficiaries for purposes of determining the distribution period pursuant to this paragraph, and
  - (III) at least one of the beneficiaries of which is an eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii) **[disabled or chronically ill]**"

III. Partial Elimination of Stretch IRA
E. Trusts as EDBs (cont.)

Special Rule for an "Applicable Multi-Beneficiary Trust"

- I.R.C. § 401(a)(9)(H)(iv) "SPECIAL RULE IN CASE OF CERTAIN TRUSTS FOR DISABLED OR CHRONICALLY ILL BENEFICIARIES.—In the case of an applicable multi-beneficiary trust, if under the terms of the trust—
  - (I) it is to be divided immediately upon the death of the employee into separate trusts for each beneficiary, or
  - (II) no individual (other than an eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii)) has any right to the employee's interest in the plan until the death of all such eligible designated beneficiaries with respect to the trust,

for purposes of a trust described in subclause (I), clause (ii) **[life expectancy payout period]** shall be applied separately with respect to the portion of the employee's interest that is payable to any eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii) **[disabled or chronically ill]**; and,

for purposes of a trust described in subclause (II), subparagraph (B)(iii) **[life expectancy payout period]** shall apply to the distribution of the employee's interest and any beneficiary who is not such an eligible designated beneficiary shall be treated as a beneficiary of the eligible designated beneficiary upon the death of such eligible designated beneficiary."

- Outstanding Question: For a trust described in (II) which has multiple EDBs as beneficiaries, whose life expectancy is used? The oldest?

III. Partial Elimination of Stretch IRA
F. Other Special Problems with Trusts

1. Subtrusts for Children. Whose age controls in determining whether one or more subtrusts are EDBs?

Example: Decedent has three children, ages 27, 18 and 12. The beneficiary of decedent's IRA is a conduit trust to be divided into separate subtrusts for benefit of "living issue, per stirpes."

What is the payout for the 18 and 12-year old children? The subtrust for the 27-year old child is not an EDB because the child has already reached the age of majority and all distributions from the IRA must be paid to that subtrust within 10 years of the decedent's death. But, what about the other two children? Can the subtrusts for the 18- and 12-year old children pay the benefits over those children's respective life expectancies until they attain the age of majority, and then pay all remaining distributions within 10 years thereafter?

III. Partial Elimination of Stretch IRA
F. Other Special Problems with Trusts (cont.)

2. Conduit Trust for EDBs. If a remainder beneficiary of a conduit trust for an EDB is also an EDB, does the remainder beneficiary have to use the 10-year payout rule?

Example: Decedent has two siblings who are not more than 10 years younger than the decedent. The beneficiary of decedent's IRA is a conduit trust for the benefit of decedent's sister who is 8 years younger. Upon the sister's death, the remainder is then paid to decedent's brother who is 6 years younger than the decedent.

Sister can take distributions over her life expectancy. What happens when she dies? Can the brother take distributions over his life expectancy, or must all be paid out within 10 years of sister's death?

III. Partial Elimination of Stretch IRA
G. Effective Date

1. The effective date for these changes is for decedents dying after December 31, 2019.

2. But, if a decedent died on or before December 31, 2019, and his or her DB dies <u>after</u> December 31, 2019, the deceased DB is treated the same as a deceased EDB under the SECURE Act rules, meaning that all remaining benefits must be distributed within 10 years following the DB's death.

INTRODUCTION TO THE CARES ACT

“Coronavirus Aid, Relief, and Economic Security Act” (“CARES Act”) of 2020

- Passed by Congress in March of 2020
- Provides relief to taxpayers in light of the pandemic
- The following slides discuss the provisions of the CARES Act which affect retirement plans

I. RMDs waived for 2020

- A. RMDs from individual account retirement plans and IRAs are waived for tax year 2020
  - Individual account retirement plans include 401(k), profit sharing, 403(b) and state-sponsored 457(b) plans
    - These plans will hereinafter be referred to as "retirement plans"
  - The RMD waiver does not apply to benefits from a defined benefit plan
    - These are typically paid in the form of a lifetime annuity
- B. Individuals affected by RMD waiver:
  - Employees/IRA owners who have an RMD requirement in 2020
    - Including those who first attained age 70 ½ (or terminated employment, if applicable) in 2019 and delayed taking their first RMD until 2020
      - Prior to the CARES Act, this first RMD must have been withdrawn by April 21, 2020.
  - Individuals who have an RMD requirement for 2020 as <u>beficiaries</u> under an inherited IRA/of a deceased retirement plan participant
    - If such beneficiary is required to take all distributions from the plan or IRA within five calendar years following the death of the participant in the retirement plan or the IRA account holder, the 2020 year does not count in determining the five-year period.
      - Note: The CARES Act does not address whether the 2020 year counts in determining a 10-year payout period (which applies to DBs under the SECURE Act)

II. RMD Rollbacks in 2020

- A. If an individual has already withdrawn his or her RMD for 2020 or has withdrawn the first year's 2019 RMD in 2020, the withdrawn amount may be rolled back to (a) the retirement plan (if the plan accepts rollbacks) or (b) an IRA, within 60 days from the date of withdrawal.
  - If the distribution is rolled back to a retirement plan or IRA, the distribution will not be taxable in 2020.
- B. This rollback rule does not apply to 2020 RMDs received by a beneficiary:
  - under an inherited IRA, or
  - of a deceased participant in a retirement plan.
- C. You can make only one tax-free rollback of an IRA distribution received during any one-year period:
  - Unless the IRS waives this one-year limitation, you cannot make your one IRA rollover in 2020 if you (a) had received another distribution from an IRA within the preceding one-year period and (b) made a tax-free rollover of that distribution to an IRA.
    - This one-year limitation does not apply to an IRA distribution that is rolled back tax-free to any other type of retirement plan that accepts rollovers.

II. RMD Rollbacks in 2020

- Example: If you are taking RMDs and withdrew all or any portion of your 2020 RMD on February 15, 2020, you will have until April 15, 2020, to roll back all or any portion of the RMD to an IRA or to a retirement plan that will accept the rollback.
  - However, if you received the distribution on February 15, 2020, from an IRA, you cannot roll the 2020 distribution back to an IRA if you received any other distribution from an IRA (not necessarily the same IRA) on or after February 15, 2019, and had made a tax-free rollback of that prior distribution to an IRA.
- Example: If you attained age 70½ anytime during 2019 and did not withdraw your 2019 RMD until March 2, 2020, then that withdrawn RMD is also eligible for tax-free rollback until May 1, 2020.
  - However, if you withdrew all or any portion of your RMD in calendar year 2019, rather than waiting until April 1, 2020, to take your first RMD, then the 2019 distribution is not eligible for rollback.
- There is a chance that the IRS may extend the rollback period of an RMD received in 2020 (as it did when RMDs were waived in 2009 during the Great Recession).
  - If you have taken an RMD in 2020 and are within 60 days of the withdrawal, you should not count on the IRS extending the 60-day period, and should immediately make a tax-free rollback of the RMD if you want to avoid income taxes on the distribution in 2020.
  - If you are already outside the 60-day window and still want to make a rollback, you should watch for any reports that the IRS has extended the 60-day window.

III. Changes to Withdrawal and Loan Rules (Introduction)

A. Participants in certain retirement plans can make penalty-free withdrawals of up to $100,000 per calendar year from their plan and request loans of up to $100,000 if the withdrawal or loan is for a coronavirus-related reason.

B. Coronavirus-related reasons include:

- being diagnosed with the SARS or COVID-19 diseases, including the diagnosis of the individual's spouse or dependent;
- experiencing adverse financial consequences as a result of being quarantined, furloughed, laid off, or having work hours reduced due to such diseases;
- experiencing adverse financial consequences as a result of being unable to work because of lack of childcare due to such diseases; and
- experiencing adverse financial consequences as a result of closing or reducing hours of a business owned or operated by the individual due to such diseases

III. Changes to Withdrawal and Loan Rules (Introduction, cont.)

C. The changes to the withdrawal and loan provisions apply to the following types of plans:

- qualified retirement and annuity plans described in I.R.C. §§ 401(a), 401(k) and 403(a)
- annuity contracts described in § 403(b)
- deferred compensation plans, described in § 457(b), that are maintained by a State and any political subdivision or agency of a State, and
- the new withdrawal rules apply to individual retirement accounts and annuities described in § 408 (IRAs);
  - Loans may not be made to individuals from IRAs, and this has not changed under the new rules

D. With respect to employer-sponsored retirement plans, the new withdrawal and loan rules only apply if the employer has elected to adopt amendments to the retirement plan incorporating the new rules. The CARES Act does not require an employer to permit withdrawals and loans from its retirement plans.

IV. Penalty Free Withdrawals

The changes relating to coronavirus-related withdrawals include the following:

- The 10% early distribution penalty on amounts received prior to age 59½ is waived.
- The maximum amount that can be withdrawn during any one calendar year to an individual from all sources is $100,000.
- All retirement plans of an employer or related employer under which the individual participates are aggregated for the $100,000 limit.
- The restriction on 401(k), 403(b) and 457(b) plans prohibiting in-service withdrawals prior to age 59½ is waived.
  - However, the similar restriction on defined benefit and money purchase pension plans prohibiting in-service withdrawals prior to age 59½ is <u>not</u> waived.
- Taxes on the amount withdrawn will be paid ratably over a three-year period beginning with the year of withdrawal, unless the participant elects to have the entire withdrawal taxed in the year of receipt.
- Within three years of receiving a distribution, a participant may generally make a tax-free rollback to a retirement plan of all or any portion of the amount withdrawn.
  - Note: If a plan does not accept rollover contributions, the plan is not required to change its terms or procedures to accept the rollback.

V. Loan Limits Increased and Loan Terms Extended

- For the 180-day period beginning March 27, 2020, and ending September 22, 2020, a participant with a coronavirus-related reason may borrow up to the lesser of $100,000 or 100% of the participant's vested benefit in the plan (when combined with all other loans made to the participant from the plan and all other plans maintained by the employer or a related employer).
  - This amount has increased from the lesser of $50,000 or 50% of the participant's vested benefit in the plan, which is the current limit applicable to loans from retirement plans.

- If a participant who has a coronavirus-related reason also has a loan that is due between March 27, 2020, and December 31, 2020, the loan may be extended for up to an additional one-year period, so long as the interest and principal installments are re-amortized to take into account the extended period. In addition, the five-year limit on the term of the loan is extended by the same period.

Questions?